In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 642

P. J. LYNCH, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (R. 154–162) is reported at 192 F. 2d 718. The views of the District Court are included in a letter dated July 26, 1950 (R. 16–17), and in formal findings of fact and conclusions of law (R. 11–15).

JURISDICTION

The judgment of the Court of Appeals (R. 162–163) was entered November 23, 1951. A petition for rehearing, filed by the taxpayer on December 21, 1951, was denied December 27, 1951. (R. 163.) The petition for a writ of certiorari was

filed on March 10, 1952. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTIONS PRESENTED

1. Whether the profits from the sale of a specified quantity of apples, which a corporation had transferred to its stockholders as a purported dividend in kind, were taxable to the corporation.

2. Whether storage fees which had been earned by the same corporation prior to its liquidation, but which had not been paid to it, were properly included in its taxable income.

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved are set out in the Appendix, *infra,* pp. 11–14.

STATEMENT

The facts, as they relate to the two questions raised by the petition for a writ of certiorari, may be summarized as follows:

1. The Washington Fruit & Produce Company, a corporation (hereinafter referred to as the corporation), was engaged in growing, warehousing and marketing fresh fruits and vegetables. (R. 12.) The taxpayer and three other persons were the stockholders of that corporation. (R. 74.) After the liquidation of the corporation, its stockholders were assessed, as transferees, for certain deficiencies in its taxes.

On February 28, 1944, the corporation declared a dividend in kind of a lot of 21,977 boxes of

apples. (R. 12, 29, 47, 91.) At the same meeting the stockholders entered into a contract (R. 33; Ex. 2) with the corporation to dispose of the lot of apples for the stockholders and account to them for the net proceeds (R. 37, 57, 95), after deducting washing, packing and storage costs (R. 53). None of the apples were ever delivered to any of the stockholders and there was no intention to do so. (R. 56.) At that time the corporation had sufficient orders on hand so that the sale of the apples was accomplished merely by accepting orders. (R. 51, 81, 98.) The dividend was declared for the sole purpose of obtaining a tax advantage to the stockholders (R. 97, 101) and to the corporation (R. 102, 139, 141). The sale of the apples under the contract was begun on March 4, 1944, and they were all marketed by the end of April, 1944. (R. 64–65.) The corporation's bookkeeper rendered a statement of receipts and charges made against the stockholders as a settlement sheet of the transaction (R. 35; Ex. 3), and the stockholders were paid the net proceeds (R. 37, 98). The corporation was liquidated on April 29, 1944. (R. 12.)

The Commissioner of Internal Revenue determined that the sale of the apples by the corporation was a sale on its own account and that the excess of the sales price over the cost to the corporation was income to it. (R. 12, 13, 16.) Finding that the dividend was a true dividend in kind and that the proceeds of the sale were

not taxable as income to the corporation, the District Court ruled against the Commissioner's determination and in favor of the taxpayer. (R. 13, 16–17.) The Court of Appeals, on the other hand, held that this finding of the District Court was clearly erroneous and accordingly reversed the latter's judgment on this point. (R. 156, 162–163.)

2. In addition to its activities mentioned above, the corporation also engaged in the business of storing fruit, meat and other products. (R. 38.) Its charges for storage were normally billed against customers at the time the stored goods were removed from its warehouse. (R. 40, 93.) The corporation generally accrued expenses incident to its business (R. 61, 65, 121, 133) but did not include in income its charges for storages until they were paid. (R. 59, 65–66.) That practice usually correctly reflected the corporation's income for its fiscal year because ordinarily most of the stored goods were removed from its warehouse and sold by or before the end of its year in the normal operation of the corporation's business. (R. 46, 88–89, 115, 116.)

The corporation was voluntarily liquidated on April 29, 1944. (R. 12, 38.) At that time it had a contract with the Federal Government for the storage of various products (R. 41, 93), which specified a monthly storage charge (R. 17, 94, 118). At April 29, 1944, the storage charges earned upon the government products then in

the corporation's warehouse amounted to $37,225.96. (R. 117.) No part of this amount was included in the corporation's income tax return for the period ended April 29, 1944, upon its liquidation. (R. 117, 121.) The products stored for the Government ordinarily would remain in the corporation's warehouse from one to six months, awaiting ships for loading and transhipment (R. 58, 129), and those in storage at April 29, 1944, were only such products as had not been removed because of the lack of means of transshipment (R. 58).

The Commissioner of Internal Revenue determined that the earned charges of $37,225.96 for government storage were includible in the corporation's income for the period ended April 29, 1944 (R. 13), and the District Court (R. 18–19) and the Court of Appeals (R. 162–163) sustained that action.

ARGUMENT

The decision of the Court of Appeals reversing the District Court upon the first question raised in the petition for a writ of certiorari and affirming its decision upon the second question (R. 162–163) is correct.

1. The District Court clearly erred in finding that the profits from the sale of the apples was not income to the corporation. The crux of the matter was, as the Court of Appeals concluded (R. 156), that the dividend declared on February 28, 1944, was that of a going concern out of

its stock in trade. As that court pointed out, it is clear that the shareholders caused the dividend to be declared with the knowledge and expectation that the property distributed would be sold immediately by the corporation in the normal course of its business, in essentially the same manner, and it is fair to assume to the same persons to whom it would have been sold had there been no dividend declared. (R. 156–157.) In the circumstances there was, as the Court of Appeals said (R. 157), no motive for the dividend other than to escape taxation. That conclusion is borne out by the record which manifests that the dividend was declared for the purpose of obtaining a tax advantage to the stockholders (R. 97, 101) and to the corporation (R. 102, 139, 141). In fact the District Court found that the primary motive for the declaration of the dividend was to reduce the income tax liability of the corporation (R. 17).

In that light the Court of Appeals correctly decided that the dividend was not the kind of distribution contemplated by Section 115 (a) of the Internal Revenue Code (Appendix, *infra*, p. 12). The corporate tax is aimed primarily at the profits of a going concern (*United States* v. *Cumberland Pub. Ser. Co.*, 338 U. S. 451, 454–455) and where a commercial or industrial transaction described in the taxing statutes is not one entered into for commercial or industrial purposes but is made for no other purpose than to escape

taxation, it must be ignored for tax purposes (*Commissioner* v. *Transport Trad. & Term. Corp.*, 176 F. 2d 570, 572 (C. A. 2), certiorari denied, 338 U. S. 955). See also *Commissioner* v. *Court Holding Co.*, 324 U. S. 331; *Wichita Term. El. Co.* v. *Commissioner*, 162 F. 2d 513, 515 (C. A. 10); *Fairfield S. S. Corp.* v. *Commissioner*, 157 F. 2d 321 (C. A. 2), certiorari denied, 329 U. S. 774; *Hellebush* v. *Commissioner*, 65 F. 2d 902 (C. A. 6); and *Commissioner* v. *First State Bank*, 168 F. 2d 1004 (C. A. 5), certiorari denied, 335 U. S. 867.

The petitioner asserts that the decision of the court below is in conflict with the holding of this Court in *Gregory* v. *Helvering*, 293 U. S. 465. (Brief in Support of Petition for Certiorari, pp. 14–15.) It was stated in that case that an ulterior purpose to avoid taxation does not nullify a corporate act for tax purposes. But the Court did not hold that when the only effect of the act is to avoid taxation and when the procedure followed had no other purpose or result, it must be taken at face value. In fact, in that case a purported corporate reorganization was disregarded because it was a mere artifice (293 U. S. 465, 470). The conclusion of the court below that the purported dividend did not result in divesting the corporation of the income resulting from the sale of the apples is entirely consistent with, and is supported by, that holding.

Nor does the decision of the Court of Appeals do violence to Rule 52 (a) of the Federal Rules

of Civil Procedure which provides that findings of fact shall not be set aside unless clearly erroneous. Here there was no conflict in the evidence as to the basic facts. Both courts recognized that the motive of the purported dividend was to avoid taxation. The only question was whether or not the court was bound to accept the artifice as real, and the court below properly held that it was not so bound.

The decision of the Court of Appeals in this case is not in conflict with any other decision and raises no important question not previously resolved. There is thus no occasion to grant the writ with respect to the first question which the petition raises.

2. The applicable statutory provisions, Sections 41 and 42, Internal Revenue Code, and the related provisions of Treasury Regulations 111 (Appendix, *infra,* pp. 11–14) were correctly applied by the District Court and the Court of Appeals in deciding the second question raised in the petition in this case. The Commissioner of Internal Revenue has broad discretion to require that income be reported by a method which clearly reflects that income (Section 41, Internal Revenue Code, Appendix, *infra,* p. 11, and *Brown* v. *Helvering,* 291 U. S. 193, 203). Even the fact that the Commissioner has, in prior years, accepted returns upon a basis other than that required for the taxable period involved does not preclude him from insisting upon a method which will clearly reflect

income for the period being audited (*Carver* v. *Commissioner,* 173 F. 2d 29 (C. A. 6th) and *William Hardy, Inc.* v. *Commissioner,* 82 F. 2d 249, 250 (C. A. 2d).

Here, in prior years, returns prepared upon the accrual basis in part had been accepted even though they included storage charges only when paid, because the payments had usually taken place before the close of the Corporation's fiscal year. The inconsistency was therefore not material. It is obvious that that method failed to reflect income clearly in the year of the corporation's liquidation which took place on April 29, 1944. By placing in gross income for the taxable period ending upon that date, the storage charges of $37,225.96, which had accrued during that period, the Commissioner, far from repudiating the method used in prior years, merely applied the accrual method to all items of income and expense up to the date of dissolution. Under those circumstances his action was correct. See *Franklin County Distilling Co.* v. *Commissioner,* 125 F. 2d 800 (C. A. 6th), and *Jud Plumbing & Heating* v. *Commissioner,* 153 F. 2d 681 (C. A. 5th).

Under well established rules it is the *right* to receive income and not the actual receipt which determines inclusions in gross income upon the accrual basis (*Spring City Co.* v. *Commissioner,* 292 U. S. 182, 184–185). Here, as the Court of Appeals pointed out (R. 160–161), the corporation

prior to the liquidation had faithfully performed the services which created its right to the storage charges in question and the amount thereof was readily ascertainable at that time. In this light alone the decision of the District Court and that of the Court of Appeals in this case were manifestly correct.

There is no conflict of the decision here with other decisions. In so asserting (Br. 15, 16) the taxpayer begs the question by a mere recitation of postulates. Nothing in the decision he seeks to have this Court review offends these general propositions of law.

CONCLUSION

The decision below is correct. There is no conflict of decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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APRIL 1952.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but * * * if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U. S. C. 1946 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for

the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

(26 U. S. C. 1946 ed., Sec. 42.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, (or (2) out of the earnings or profits of the taxable year * * *.

* * * * *

(26 U. S. C. 1946 ed., Sec. 115.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.41–1. *Computation of Net Income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of

which items of gross income and deductions are to be accounted for. (See sections 29.42–1 to 29.42–3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

SEC. 29.41–2. *Bases of Computation and Changes in Accounting Methods.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. * * * All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *

* * * * *

SEC. 29.41–3. *Methods of Accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. * * *

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SEC. 29.41–4. *Accounting Period.*—The return of a taxpayer is made and his income computed for his taxable year, which in general means his fiscal year, or the calendar year if he has not established a fiscal year. (See section 48.) The term "fiscal year" means an accounting period

of 12 months ending on the last day of any month other than December. * * *

SEC. 29.42–1. *When Included in Gross Income.*—(*a*) *In general.*—Except as otherwise provided in section 42, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * *

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